REDACTED SUBJECT TO PROTECTIVE ORDER DATED OCTOBER 24, 2017

DECEMBER 6, 2017 OVER ORDER PREMIUM HEARING

TESTIMONY OF EVAN KINSER
VICE PRESIDENT - MILK SUPPLY DEAN FOODS COMPANY
IN SUPPORT OF THE PENNSYLVANIA ASSOCIATION OF MILK DEALERS' PROPOSAL

PRE-SUBMITTED OCTOBER 24, 2017

Submitted October 24, 2017

My name is Evan Kinser and I serve as Vice President – Milk Supply for Dean Foods Company. While I have been before the Board prior to today there have been a lot of changes since then. I'll offer a quick summary introduction of my background.

I grew up on a dairy farm, which my family continues to operate, in Wright County, Missouri. I earned a B.S. in Animal Science & Agricultural Economics from the University of Missouri – Columbia. While attending the University of Missouri, I worked with Dr. Ken Bailey and interned with Downes & O'Neill in Chicago. I was a research assistant for Dr. Bob Cropp at the University of Wisconsin – Madison while earning my MBA in Agribusiness. In addition to holding an assistantship with Dr. Cropp, I worked for both Blimling and Associates, headquartered in Cottage Grove WI, and Foremost Farms USA, headquartered in Baraboo, WI. After graduation, I continued to work for Foremost Farms for six years and last held the position of Director of Fluid Milk Marketing. In my current position I am responsible for both cooperative and independent milk supply for Dean. In my career, I have been responsible for forward contracting programs, dairy policy on both state and federal level, and commodity trading. Specific to this hearing, I am responsible for milk cost for Dean and I consult on RFPs from customers when Dean is putting together the raw milk cost for the RFPs.

Dean Foods Company (Dean) supports the PAMD proposal to lower the over order premium from $1.60 to 75-cents for nine months through September 2018.

I am authorized by the Pennsylvania Association of Dairy Cooperatives (PADC) to represent to PMMB that PADC does not oppose the premium level of 75-cents for nine months through September 2018.

While I understand PAMD's request to reduce Over Order Premiums is not likely a popular idea with many dairy farmers, the reduction is necessary to ensure that Pennsylvania dairy farmers continue to have the option to sell milk to their local plants and dealers.

Changes in Fluid Milk Demand

U.S. fluid milk consumption has, for some time, been on a long-term decline. The rate of that decline has increased significantly in recent years. As Exhibit 1 shows, total fluid milk consumption as estimated by the USDA Economic Research Service, has declined from 54.8 billion pounds in 2007 to 49.9 billion pounds in 2016. The reduction in fluid milk sales has led to increased unused plant capacity in fluid milk plants. This surplus capacity has ultimately led to increased competition for sales among fluid milk processors.

Current Market Conditions

The U.S. milk market, especially the Midwest and Northeast, remains in an over-supply situation. Milk production in the U.S. has increased year-over-year for 45 consecutive months. Milk in various parts of the U.S. has sold significantly under class prices in order to find a home. So far in 2017, through September, domestic milk supplies have increased 1.9% year-over-year (Exhibit 2). The milk production growth nationally is fueled by both an increase in output per cow and a 69,000 head increase in the total dairy cows on farm. Currently, the U.S. dairy herd is at its highest level in just over 20 years at 9.4 million head on farm (Exhibit 3). USDA estimates as of October call for the U.S. milk supply to increase an additional 4.2 billion pounds, or 1.9%, year-over-year in 2018 (Exhibit 4).

Looking specifically at Pennsylvania, milk production has increased 0.84% year-over-year through September to 8.275 billion pounds. Pennsylvania milk production in the first half of 2017 was above any production level experienced in recent history at 6.49 billion pounds. Using the growth rates experienced in January – September, I extrapolated out an estimate for second half 2017 production. As Exhibit 5 shows, production estimates for the back half of 2017 would also be higher than year-prior levels. The growth in the PA milk supply was the result a 2.3% average increase in output per-cow during the first nine of months of 2017 (Exhibit 6). This increase in the output per-cow offsetting a 5,000 head decline in the Commonwealth's dairy herd.

The milk supply in Pennsylvania has been on a noticeable upswing since 2014. As illustrated in Exhibit 7, milk production in the Commonwealth has increased in 35 out of 45 months between January 2014 and September 2017. Compared to year prior levels, milk production increased 418.0 million pounds over this time period. This increased milk production in both Pennsylvania and most states surrounding the Commonwealth have ultimately led to constrained manufacturing plant capacity and caused an increase in hauling costs as milk has had to travel further to find available manufacturing plant capacity.

Marketing conditions in the Northeast and Mideast remain challenging. Strong milk production growth in these two has weighed heavily on these individual markets. The Northeast, which because of the order's pooling regulations, typically has minimal de-pooling of milk on the order, has experienced a 392.7 million pound increase (nearly 73 truckloads per day), to 20.7 billion pounds, in milk pooled on the order in the first nine months of 2017 (Exhibit 8). This is coming off of a 691.4 million pound increase experienced during this same time frame in 2016. In Federal Order 33, the Mideast Order, the total volume of milk pooled on the order equaled 15.63 billion pounds in the first nine months of the year, an increase of 4.7% (Exhibit 9).

While the amount of milk pooled on these two orders has increased noticeably over the past few years the same cannot be said for the pounds of Class I milk. The loss of Class I volume has been particularly acute on Federal Order 1. The chart on Exhibit 10 shows the monthly Class I pounds in the Federal Order 1 pool. In 2005 there were approximately 10.6 billion pounds of Class I milk in the Federal Order 1 pool. The Class I pool volume declined to approximately 9.1 billion in 2014, approximately 8.9 billion in 2015 and approximately 8.8 billion pounds in 2016. During the first nine months of 2017 the Class I volume in the pool equaled approximately 6.5 billion pounds which represents a nearly 46 million pound (nearly 3 ½ truck loads per day) decline compared to year prior levels. On a percentage level basis, the Class I share of the pool volume has declined from an average of 45.1% in 2005 to 35.4%, 34.5%, 32.7% in 2014 through 2016, respectively. The Class I percentage in Federal Order 1 between January – September 2017 averaged 31.0%.

Significantly increased milk production coupled with reduced fluid milk sales has ultimately put increased pressure on access to manufacturing facilities. The lack of available manufacturing plant capacity to handle the increased milk production caused milk to travel farther to find a home or in some cases when a home wasn't available, to be dumped. The amount of milk classified as animal feed and milk dumped in both Orders 1 and 33, while declining slightly year-over-year, remains historically elevated. During the first 9 months of the year 150.9 million pounds of milk were dumped in Order 1 while an additional 58.5 million pounds of milk was dumped Order 33. Combined this is about 15 ½ truck loads per day during the 9 month period. Monthly milk dumped and animal feed volumes in recent years can be found in Exhibit 11.

With respect to dumped milk, Dean has been asked to take milk from **[BEGIN CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** [redacted] **[END CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** in order to separate the cream from skim so the cream could be sold for value and the skim could then be dumped. As opposed to simply dumping an entire load of milk, this process of cream separation before dumping the remaining skim is known as "salvage", and is another indication of the weak demand for fluid milk, which further supports a decrease in over-order premiums.

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Salvaging is not profitable. Based on my own experience, I would say that salvaging is done to mitigate losses rather than to generate profits. Every time we looked at it when one considers the cost to run the plant to convert milk into cream and skim and value with freight included for those two products, it was not profitable. If an organization is doing this it is to limit the loss, not to make money. To that point, at times it could be very costly to engage in salvaging such that dumping might make more sense. Both scenarios are yet another indication of the surplus milk situation and the pressure on premiums.

I do not know all of what prompted its release, but I have included a press release (Exhibit 12) from the Market Administrator of the Northeast Federal Milk Order talking about how he will be exercising his authority to enforce payment of announced minimum prices. In the press release the Market Administrator indicates that it had come to his attention that pool plants were paying less than classified prices to purchase milk, which of course is another indication of the supply imbalance and the downward, even negative pressure on premiums. To be clear Dean Foods has not faced any action by any Market Administrator for such a concern.

In Exhibit 13 I would like to focus on the lack of plant investment to provide a home for milk. This shows the level of growth by state for the 12-months leading up to June 2017 and the plant investments that Rabobank knew of at that time – June 2017. Notice the lack of plant capacity investment in PA and North and East where the depth of the green highlighting indicates the rate of change in farm production. I will acknowledge you do see some negative milk production outside of PA, however that loss is offset by growth in PA not to mention the significant growth in NY.

All of this information leads to the inevitable conclusion that the supply demand imbalance is serious and sustained and should not be ignored by the PMMB.

Fluid Milk Competition

The loss of Class I sales has created capacity in plants across the fluid processing industry. Dean Foods has not been immune to this trend. We have addressed this in part with one plant closure this year in Richmond, VA. We are experiencing a very competitive market with processing plants looking to refill capacity and retail and food service customers seeking to leverage the competitive processor environment to achieve the lowest price. While it may be obvious to this audience, I would like to clarify that the excess fluid milk processing capacity does little to help with dairy farmer excesses due to the limited shelf life of fluid milk products.

John Pierce will discuss the level of RFP activity when he testifies on December 6, however, I can tell the Board that in many cases, **[BEGIN CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL** [redacted]

[redacted] **[END CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]**

I believe each of you would agree with the following: 1) Dairy farming isn't a short-term business in any respect; and 2) Dairy farmers have good and long memories. I believe those two perspectives are key to understanding what is going on. A milk buyer like Dean or our competitor knows the key to our business is a high quality and competitively priced raw milk supply. If you work directly with dairy farmers to accomplish that you also know the sale of milk is key to the dairy farmer's existence. I believe milk buyers are concerned due to the surplus if they release a dairy farmer it might be fatal to that business. **[BEGIN CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** [redacted] **[END CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** In this environment, therefore, a decision to release farmers could well mean they will not be there if the time comes to ramp back up.

If a plant does not have enough sales for their dairy farmer supply there are three options: 1) terminate farm(s) (often the last resort as described above), 2) Find an alternate home(s), 3) find a fluid milk product sale to use the milk and the plant. I don't want to gloss over why #2 is a problem. With the current surplus and the lack of investment in manufacturing assets, by in large the owners of manufacturing plants are either cooperatives or have contracts with farmers or cooperatives. In both cases it has drastically limited the ability of a 3rd party to make a sale for surplus milk. Dumping milk is very expensive, which leads me back to #3 **[BEGIN CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** [redacted] **[END CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]**

In addition, we know premiums are moving lower as we have seen a reduction in premiums both in and around Pennsylvania. **[BEGIN CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** [redacted]

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[redacted] **[END CONFIDENTIAL ATTORNEY EYES ONLY MATERIAL]** This causes our Pennsylvania plants to be at a competitive disadvantage to plants located outside of the Commonwealth for sales into the Commonwealth. We must have a raw milk price that is within reasonable alignment with the competing non-PA plants.

I return to where I started. I understand this is not likely to be a popular concept in many segments of the dairy farming community. However, a lower mandated Over Order Premium is needed to maintain the local market for Pennsylvania farmers. We appreciate the update on the fuel surcharge, which was directionally correct. However, the increased RFP activity and continued supply imbalance has caused Dean to realize that further significant adjustments to the Over Order Premium are needed to align the mandated premium more closely with out-of-state processors' milk cost. Please support the position of PAMD and lower the $1.60 mandated premium to 75-cents. Thank you for your attention. I will be glad to answer any questions now.